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The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be an S corporation effective Date 2. Pursuant to an

agreement dated Date 3, A and B, established Trust 1, a revocable trust treated as a wholly-owned grantor trust under §§ 671 and 676. A and B transferred shares of X stock to Trust 1.

On Date 4, A died and Trust 1 ceased to be a grantor trust with respect to A's interest, but continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2 year period beginning on the day of the deemed owner's death. On Date 5, by operation of the governing instrument of Trust 1, shares of X were transferred to Trust 2, Trust 3, and Trust 4. X represents that the trusts qualified to elect to be treated as qualified subchapter S trusts (QSST), however, the sole income beneficiaries of the separate shares of each trust failed to make timely QSST elections within the meaning of § 1361(d)(2) thereby causing X's S corporation election to terminate on Date 5.

On Date 6, B died and Trust 1 ceased to be a grantor trust with respect to B's interest, but continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2 year period beginning on the day of the deemed owner's death. X represents that Trust 1 qualified to elect to be treated as a QSST; however, the sole income beneficiaries of the separate shares of the trust failed to make a timely QSST elections within the meaning of § 1361(d)(2). The failure to make the QSST elections would have terminated X's S corporation election had it not already been terminated.

On Date 7, by operation of the governing instrument of Trust 1, shares of X were transferred to Trust 5. On Date 8, Trust 4 transferred shares of X to Trust 6. X represents that Trust 5 and Trust 6 qualified to elect to be treated as QSSTs; however, the sole income beneficiaries of the separate shares of the trusts failed to make timely QSST elections within the meaning of § 1361(d)(2). The failure to make the QSST elections would have terminated X's S corporation election had it not already been terminated.

X represents that all circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that X filed returns consistent with X's status as an S corporation. X also represents that Trust 2, Trust 3, Trust 4, Trust 5, and Trust 6 filed returns consistent with rules applicable to QSSTs. X and its shareholders agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(b)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted S corporation shareholder, but only for the two-year period beginning on the day of the deemed owner’s death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner’s death.

Section 1361(d)(1) provides that a QSST, whose beneficiary makes an election under § 1361(d)(2), will be treated as a trust described in § 1361(c)(2)(A)(i), and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the trust which consist of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1.1361-1(j)(3) provides that for purposes of § 1361(c) and § 1361(d), a substantially separate and independent share of a trust, within the meaning of § 663(c) and the regulations thereunder is treated as a separate trust. For a separate share which holds S corporation stock to qualify as a QSST, the terms of the trust applicable to that separate share must meet the QSST requirements stated in § 1.1361-1(j)(1)(i) and (ii).

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center where the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that

the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides, in relevant part, that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides, in part, that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated beginning on Date 5, when the stock in X was transferred to Trust 2, Trust 3, and Trust 4 because the income beneficiaries of Trust 2, Trust 3, and Trust 4 failed to timely file the required QSST elections under § 1361(d)(2). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Moreover, had X's S corporation election not already terminated, it would have terminated on each of the following dates: Date 7 and Date 8. Similarly, these terminating events would have been inadvertent terminations within the meaning of § 1362(f).

Therefore, we conclude that X will continue to be treated as an S corporation for the period from Date 5 provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). This ruling is conditioned upon the income beneficiaries of Trust 2, Trust 3, Trust 4, Trust 5, and Trust 6 filing a QSST election for each trust effective upon the date the trust received shares of X. All elections must be filed with the appropriate service center within 120 days of the date of this ruling. A copy of this letter should be attached to each QSST election.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be treated as an S corporation or whether Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, and Trust 6 are eligible to be treated as a QSST. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this Letter
Copy for § 6110 purposes

cc: